



THE INFLUENCE OF THE RECENT GLOBAL
FINANCIAL CRISIS ON CORPORATE VOLUNTARY
DISCLOSURES IN MALAYSIA

BY

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ABSTRACT

The recent global financial crisis was of great concern to many companies in the world, even those with the most developed governance structures (Goldin and Vogel, 2010). The current study attempts to provide empirical evidence on the influence of the recent global financial crisis in the extent and quality of Corporate Voluntary Disclosures (CVDs) in the Malaysian context. The study examines the annual reports of 85 listed Malaysian companies on Bursa Malaysia. In order to provide a meaningful insight into the influence of the financial crisis on CVDs, the research examines two data sets, before (2006) and after (2009) the recent global financial crisis. The study also investigates factors influencing the extent and quality of CVDs (i.e., corporate governance variables, ownership structure attributes, and corporate characteristics variables). The paper formulates 9 null hypothesis based on three theories namely, legitimacy theory, agency theory, and signalling theory. The findings reveal that both the extent and quality of CVDs significantly increased following the recent global financial crisis. Legitimacy theory posits that companies increase their annual report disclosures following a crisis period in order to avert legitimacy threats and appear a socially aware company. The results also seem to support the view that companies utilize their annual report disclosures as a means of influencing society's perception of their operations, and as a means of legitimizing their future existence. In terms of factors influencing the extent and quality of CVDs, multiple regression analyses indicate that company size, profitability, and government ownership significantly and positively associate with the CVDs in the year 2006. None of the corporate governance variables examined in the study were significant in the year 2006. However, the 2009 multiple regression results show that company size and board size are significant and positive in explaining the extent and quality of CVDs in the annual reports of Malaysian listed companies. The results of the study have both theoretical as well as policy implications. Malaysian companies' responses to the recent crisis for legitimacy purposes may indicate that theories originated from the West are applicable to the developing countries. The significance of board size, one of the corporate governance variables, in 2009 appears to suggest that the revised code in 2007 may have had implications on corporate boards. Notwithstanding several limitations inherent in the study's methodology, the study contributes to the CVD literature in several ways. First, the disclosure practices "before" and "after" financial crisis has largely remained unexplored. Second, few prior studies simultaneously measured both the extent and quality of CVDs.

خلاصة البحث

كانت الأزمة المالية العالمية الأخيرة مصدر قلق كبير للكثير من الشركات في العالم ، حتى أولئك الذين لديهم هياكل الحكم الأكثر تطوراً (غولدن و فوجل ، 2010). إن هذه الدراسة تحاول تقديم الأدلة التجريبية على تأثير الأزمة المالية العالمية الأخيرة على مدى نوعية طوعية الإفصاح من جانب الشركات (CVD) في النموذج المالي. وتبحث الدراسة في التقارير السنوية لـ 85 شركة مسجلة في بورصة ماليزيا. ومن أجل توفير نظرة ذات مغزى حول تأثير الأزمة المالية على CVD ، تبحث الدراسة في مجموعتين من البيانات، وذلك قبل (2006) وبعد (2009) من الأزمة المالية العالمية. وقامت الدراسة بفحص أيضا العوامل التي تؤثر على مدى نوعية CVD من مثل : (متغيرات إدارة الشركات ، وسمات هيكل الملكية، و متغيرات خصائص الشركات). الدراسة افترضت 9 فرضيات بنيت على أساس ثلاث نظريات وهي نظرية الشرعية، نظرية الوكالة ، نظرية الإشارة. وتدل النتائج على زيادة كبيرة في كل من حجم ونوعية CVD زيادة كبيرة في أعقاب الأزمة المالية العالمية الأخيرة. تقترض النظرية الشرعية على ان الشركات تزيد في الإفصاح في التقرير السنوي بعد فترة الأزمة من أجل تفادي التهديدات الشرعية وتظهر على أن الشركة لها وعي اجتماعي. ويبدو كذلك أن النتائج تؤيد الرأي القائل بأن الشركات تستفيد من الكشف عن التقرير السنوي كوسيلة من وسائل التأثير على نظرة المجتمع لعملياتها، وكوسيلة لإضفاء الشرعية على وجودها في المستقبل. من حيث العوامل المؤثرة في CVD ، وتحليلات الانحدار المتعددة تشير النتائج إلى أن حجم الشركة والربحية، وملكية الحكومة لها ارتباط بشكل كبير مع CVD في عام 2006 مع العلم أنه لم يكن لأي من متغيرات حوكمة الشركات التي شملتها الدراسة أثر كبير في عام 2006. ومع ذلك، فإن نتائج الانحدار المتعدد 2009 تظهر أن حجم الشركة وحجم المجلس لهما أثر كبير في شرح مدى نوعية CVD في التقارير السنوية للشركات المدرجة في ماليزيا. نتائج الدراسة لها آثار نظرية و اخرى منهجية. إستجابة الشركات الماليزية للأزمة الأخيرة لأغراض شرعية تشير إلى أن نظريات نشأت من الغرب تنطبق على البلدان النامية . أهمية حجم المجلس تعتبر واحدة من المتغيرات حوكمة الشركات في عام 2009 ويبدو أن اقتراح القانون المنقح في عام 2007 قد يكون له انعكاسات على مجالس إدارات الشركات. على الرغم من العديد من القيود المتأصلة في منهجية الدراسة، ساهمت هذه الدراسة في الأبحاث المتعلقة بـ CVD من عدة طرق. أولاً ، الكشف عن الممارسات "قبل" و "بعد" الأزمة المالية و التي لا تزال إلى حد كبير غير مستكشفة. الثاني، الدراسات السابقة قليلة خاصة فيما يتعلق بقياس مدى ونوعية CVD .

APPROVAL PAGE

I certify that I have supervised and read this study and that in my opinion, it conforms to acceptable standards of scholarly presentation and is fully adequate, in scope and quality, as a dissertation for the degree of Master of Science (Accounting).

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DECLARATION

I hereby declare that this dissertation is the result of my own investigations, except where otherwise stated. I also declare that it has not been previously or concurrently submitted as a whole for any other degrees at IIUM or other institutions.

Abdifatah Ahmed Haji

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In the name of Allah most gracious and most merciful.

I dedicate this dissertation to my beloved mother Rubabi Mohamed Elmi and father Ahmed Haji Abdi, who taught me to think big and showed me love and support all in my life. Without their love and support, I would not have been able to come this far. I will forever appreciate your sacrifices. To also my brothers and sisters who one way or the other helped me accomplish my academic achievements. For that, thank you so much!

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LIST OF ABBREVIATIONS

ARs	Annual Reports
ASX	Australian Stock Exchange
BM	Bursa Malaysia
BMB	Bursa Malaysia Board
CCI	Corporate Community Involvement
CEOs	Chief Executive Officers
CFOs	Chief Financial Officers
CSD	Corporate Social Disclosure
CSR	Corporate Social Responsibility
CVD	Corporate Voluntary Disclosure
e.g.	<i>(Exempli Gratia)</i> : For example
et al.	<i>(et alia)</i> : and others
etc.	<i>(et cetera)</i> : and other similar things
FA	Financial Analysts
GLCs	Government Linked Companies
INDs	Independent Non-Executive Directors
ISE	Istanbul Stock Exchange
KLSE	Kuala Lumpur Stock Exchange
MCCG	Malaysian Code on Corporate Governance
R&D	Research and Development
RO	Research Objective
ROE	Return on Equity
RQ	Research Question

SGX	Singapore Stock Exchange
Sig	Significant
SPSS	Statistical Packages for Social Science
SSE	Swedish Stock Exchange
UK	United Kingdom
US	United States of America
VIF	Variance Inflation Factor

CHAPTER ONE

INTRODUCTION

1.0 INTRODUCTION

The recent global financial crisis was of great concern to many companies internationally (Brown, Steen and Foreman, 2009), even those with the most developed governance structures (Goldin and Vogel, 2010). The present study argues that the recent financial crisis may not only have affected the companies financially, but it might also have an impact on their corporate disclosure practices. This argument is grounded on the fact that the two (i.e., financial crisis and corporate disclosure practices) might be related (Rahman, 1998; Gul and Leung, 2004). As companies had experienced the financial crises, they might have increased/decreased the extent of their voluntary disclosures (transparency) they had previously provided.

The current research, for this reason, attempts to provide empirical evidence on the influence of the recent global financial crisis on Corporate Voluntary Disclosure (CVD) in the Malaysian context. The study examines the annual reports of 85 companies listed on Bursa Malaysia Main Market selected based on a systematic stratified random sampling. In order to provide a meaningful insight into the influence of the financial crisis, the research examines two data sets, before (2006) and after (2009) the recent global financial crisis. In doing so, the study attempts to simultaneously measure the extent (i.e., dichotomous basis) and quality (i.e., measured as total disclosure score of four point Likert scale) of CVD before and after the recent global financial crisis.

In addition, the research further aims to determine factors such as corporate governance variables, ownership structure attributes, and corporate characteristics that influence the extent and quality of Malaysian listed companies' CVDs.

The current study is a kind of “before and after” which primarily tries to examine the influence the recent financial crisis had on CVD. The present study also measures simultaneously the extent and quality of CVD of listed companies in Malaysia. It is hoped that the findings of the study will fill the gap in the CVD literature in general, and the literature in the Malaysian context in particular.

This chapter is organised in the following way. Section 1.1 provides background of the study while section 1.2 discusses research problem statement. In section 1.3 and 1.4, research objectives and research questions are presented, respectively. Sections 1.5 and 1.6 highlight contributions and motivations of the study respectively, whilst section 1.7 points why Malaysia is of particular interest to study. Finally, section 1.8 presents the outline of the dissertation.

1.1 BACKGROUND OF THE STUDY

Information disclosed in the company annual reports could either be mandatory or voluntary. In the former, Accounting Regulators in respective countries make it obligatory for companies to disclose certain type of information deemed necessary to enhance the quality of corporate reports. In the latter, the company management is given the authority to provide information other than what is required by regulation (Gray, Meek, and Roberts, 1995).

Several prior studies worldwide focused on the factors that influence companies to disclose voluntary information (Prencipe, 2004; Haniffa and Cooke, 2005; Barako, Hancock and Izan, 2006; Mohd Ghazali, 2008). For instance, Boesso

and Kumar (2007) stated that dissatisfaction with mandatory disclosure has led key stakeholders (i.e., investors) to demand firms to provide comprehensive voluntary disclosure about their past performance and long-term strategies. Moreover, it is believed that “many of the firms which have been credited with contributing to economic and technological progress have been criticized for creating social problems” (Hackston and Milne, 1996, p. 77), thus, corporate stakeholders now appear to be more concerned with adverse activities of businesses on society (Nik Ahmad, Sulaiman and Siswantoro, 2003). Accordingly, companies have been urged to become accountable to broad stakeholders by providing comprehensive corporate disclosures, not just financial but also social and environmental disclosures (Boesso and Kumar, 2007).

As a result, voluntary disclosure had been the core subject of many empirical studies undertaken in both the developed (e.g. Prencipe, 2004; Smith, Adhikari, and Tondkar, 2005; Boesso and Kumar, 2007) and developing countries (e.g. Eng and Mak, 2003; Mohd Ghazali and Weetman, 2006; Eljido-Ten, Kloot, Clarkson, 2010).

The studies found that CVD is affected by a number of different factors. They found that voluntary disclosure is influenced by a company’s ownership structure (Chau and Gray, 2002; Eng and Mak, 2003; Mohd Ghazali, 2007, Al-Akra, Eddie and Ali, 2010), company characteristics (Cooke, 1989; Pahuja, 2009), corporate governance attributes (Ho and Wong, 2001a; Cheng and Courtenay, 2006), as well as cultural values (Archambault and Archambault, 2003; Haniffa and Cooke, 2005). Many others linked voluntary disclosure to country clusters (Smith et al., 2005; Smith, Adhikari, Tondkar, and Andrews, 2010). Yet others remarked religious beliefs also have an influence on the extent of disclosures (Baydoun and Willet, 2000; Archambault and Archambault, 2003).

Additionally, several prior studies documented that sudden crisis, such as social or environmental disasters, had an impact on the level of voluntary disclosures (Blacconiere and Patten, 1994; Patten and Nance, 1998; Deegan, Rankin, and Voght, 2000; Magness, 2006; Villiers and Staden, 2006; Aerts and Cormier, 2009; Tilling and Tilt, 2010). Some of these studies found that the extent of voluntary information increased after the crisis occurred (Deegan et al., 2000) whilst others (Villiers and Staden, 2006; Tilling and Tilt, 2010) documented reduced voluntary disclosures after initial period of increases. The two opposing findings are justified by the fact that companies maintain voluntary disclosures at present levels, or increase over time, to avoid legitimacy crises (Villiers and Staden, 2006). If companies deem the crisis could have a negative impact on the firm's legitimacy, the voluntary disclosures will be increased, if not; disclosures will be maintained at their present levels (Deegan et al., 2000).

In addition to the above factors, financial crisis could also have an impact on the level and quality of voluntary information disclosed by companies (Haniffa and Cooke, 2005). There are two explanations in the literature on how the financial crisis may have an effect on the extent and quality of CVD. The first explanation assumes that in a financial crisis period in which companies are going through difficult times, companies may provide less voluntary disclosure. This explanation is supported by the proprietary costs¹ theory which assumes that firms limit their voluntary disclosures because of two costs, namely, preparation and competitive costs (Prencipe, 2004). Consistent with the proprietary costs theory, companies may not afford the costly

¹ These two costs will be further explained in the theoretical framework chapter.

process of more voluntary disclosures in a financial crisis period of time due to the economical crisis they already are experiencing.

The second explanation in the literature arises from the legitimacy theory which posits that in a recession or crisis period of time, companies may react positively by involving more corporate social responsibility (CSR) programs than they did prior to the financial crisis in order to address some perceived corporate legitimacy as this is the time the stakeholders require corporate support. Accordingly, the involvement of more social responsibility programs may lead to increased voluntary disclosures in the annual reports (see, Belkaoui and Karpik, 1989). The recent global financial crises may have led companies to involve in CSR programs to a greater extent (as a response to the crisis) than they were in non-crisis period of time. Thus, from legitimacy theory point of view, companies might have increased their CVDs in the year 2009 compared to the year 2006.

This dissertation, as a result, examines the corporate disclosures in the annual reports to investigate how companies in Malaysia reacted to the recent global financial crises by simultaneously measuring the extent and quality of voluntary disclosure. The study measures the quality of voluntary disclosures as the “total disclosure score” of a four point Likert scale (Wiseman, 1982; Eljido-Ten, 2009). In addition, voluntary disclosure in this study is defined as information not regarded as mandatory by the Malaysian Company Act 1965 as well as the Malaysian Stock Exchange listing requirements. The index used to measure CVD consists of both financial and non-financial elements (i.e., financial, strategic, and CSR).

1.2 PROBLEM STATEMENT

Prior studies have examined voluntary disclosures following the 1997 South East Asian financial crisis (e.g., Ho and Wong, 2001b; Gul and Leung, 2004; Haniffa and Cooke, 2005; Mohd Ghazali and Weetman, 2006). For instance, Ho and Wong, (2001b) argued that the absence of timely and reliable corporate information triggered the East Asian financial crisis. More specifically, Gul and Leung, (2004) stated that poor corporate disclosure was partly blamed Asian crisis. In Malaysia, Haniffa and Cooke (2005) stated that companies in Malaysia may have increased their social disclosures following the 1997 Asian financial downturn in attempt to address some perceived corporate legitimacy.

However, Mohd Ghazali and Weetman (2006) concluded that despite the disorder of the 1997 economic crisis, traditional influences of director ownership and family domination of the board outweighed the effect of government-backed accountability initiatives in determining the extent of voluntary disclosures in Malaysia. The paper implied that the accountability initiatives following the financial crisis at the time did not change much to influence CVD practices in Malaysia.

Nevertheless, none of the above studies primarily examined CVDs “before” and “after” the East Asian financial crisis. They, however, mainly used the financial crisis to theoretically justify the lower CVD practices found in the region and the lack of significant corporate governance variables even after government-backed accountability initiatives were introduced.

The current global financial crisis, however, is believed to be entirely different from the previous financial crisis (Souto, 2009; Abd Majid and Kassim, 2009; Goldin and Vogel, 2010). Souto (2009) for instance argues that the current economic and financial crisis as agreed by many economic and financial experts is the worst since

the Second World War. Similarly, Goldin and Vogel (2010) drawing lessons from the recent financial crisis argued that the crisis is the first example of a ‘systemic failure’ of the 21st century. The financial crisis begun in the U.S. and then spread globally as the world is now interconnected (Bondt, 2010). Western highly successful giants with the most developed institutional governance (e.g., Washington Mutual and Lehman Brothers Holdings Inc) both declared bankruptcy in September, 2008, due to the ongoing financial crisis.

The recent financial crisis did not remain in the Western nations but the crisis had also hit emerging economies including Malaysia (see, e.g., Abd Majid and Kassim, 2009). The impact of the recent financial crisis is also evident in the annual reports of listed Malaysian companies. For instance, below is an extract from the annual report of a listed Malaysian company (one of the sample companies in this study) describing the recent financial crisis in the Malaysian business environment:

The reduction in sales was due to the lack of buyers.as oil palm plantings ceased following the financial crisis...We believe that our investors’ engagement needs to be stepped up during the financial crisis because investors are increasingly looking for sustainability commitments as an indicator of a company’s financial viability (Annual Report, Company A, p. 11).

Similar to the 1997 Asian financial crisis, no prior study empirically investigated the voluntary disclosure practices following the recent global financial crisis. Accordingly, this study tries to examine voluntary disclosure practices before and after the recent financial turmoil in the Malaysian context. The study aims to fill a gap in the literature as it is different from the previous studies in several ways. Firstly, the study intends to examine simultaneously the extent and the quality of voluntary disclosure before (2006) and after (2009) the recent global financial crisis.

Secondly, prior studies in the voluntary disclosure literature examined the extent of CVD in relation to corporate governance factors, ownership structure attributes, and company characteristics factors. However, few studies (Boesso and Kumar, 2007; Che Haat, Abdul Rahman; Mahenthiran, 2008; Elijido-Ten, 2009) examined the determinants of the quality of CVD. Hence, the current study aims to extend the existing literature by examining both the extent and the quality of CVDs simultaneously in relation to corporate governance factors, ownership structure attributes, and company characteristics.

To recapitulate from the preceding discussion, it can be concluded that there are no studies that examined the association between financial crisis and voluntary disclosure. Therefore, the present study attempts primarily to contribute to the disclosure literature by examining the influence the recent global financial crisis may have on the extent and quality of voluntary disclosure in the Malaysian context. This has not been the subject of a prior study, both in the Malaysian context and outside Malaysia.

The study also tries to examine empirically the association between the extent and quality of CVD and other factors (e.g., corporate governance factors, firm characteristics, and ownership structure attributes). Numerous researchers examined the association between these variables and the extent of voluntary disclosure. However, the contribution of this study is that it simultaneously examines the association between these variables and both the extent and quality of voluntary disclosure. Furthermore, the revised Malaysian Code of Corporate Governance (MCCG) in 2007 may have changed the disclosure practices of Malaysian companies. Hence, the current study tries to observe the impact the revised MCCG might have on disclosure practices of the companies.

1.3 OBJECTIVES OF THE STUDY

The main objective of this study is to investigate CVDs practices following the recent global financial crisis. In order to achieve this objective, the study analyzes company annual reports before (2006) and after (2009) the recent financial crisis. The exact period of the recent financial crisis is believed to be the years 2008-2009 as stated in a recent paper by Goldin and Vogel (2010). However, other studies believe that the financial crisis may have started as early as the year 2007 (e.g., Abd Majid and Kassim, 2009). As a result, the years 2006 and 2009 are examined in the present as “before and after” the financial crisis. The research objectives (RO) of the study are as follows:

RO 1: To measure the extent of voluntary disclosure before (2006) and after (2009) the recent financial crisis in the context of Malaysian companies listed on Bursa Malaysia Main Market.

RO 2: To measure the quality (measured as total disclosure score) of voluntary disclosure before (2006) and after (2009) the recent financial crisis in the context of Malaysian companies listed on Bursa Malaysia Main Market.

RO 3: To determine factors (e.g., ownership structure, corporate governance, and corporate characteristics variables) influencing the extent and quality of voluntary disclosure of Malaysian companies listed on Bursa Malaysia Main Market.

1.4 RESEARCH QUESTIONS

The present study seeks to answer five research questions (RQs). The following are the research questions of the study: